



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE (916) 445-5580
FAX (916) 323-3387
www.boe.ca.gov

JOHAN KLEHS
First District, Hayward

DEAN ANDAL
Second District, Stockton

CLAUDE PARRISH
Third District, Torrance

JOHN CHIANG
Fourth District, Los Angeles

KATHLEEN CONNELL
State Controller, Sacramento

JAMES E. SPEED
Executive Director

July 22, 2002

Honorable Bruce Dear
Placer County Assessor's Office
145 Fulweiler Avenue
Auburn, CA 95603

Attention:

**RE: *Sprinkle/ Spray Trust Provisions - Change in Ownership/Trusts
Request No.***

Dear Mr. Dear:

This is in response to your June 27, 2002 faxed letter from _____ of your office to Assistant Chief Counsel Kristine Cazadd requesting our legal opinion concerning the applicability of change in ownership exclusions to a transfer of real property to an irrevocable trust in which the trustee has broad discretion to distribute income and principal to an unidentified class of beneficiaries. Specifically, you seek our opinion concerning 1) whether a change in ownership resulted when the property was transferred to the trust, and 2) if so, whether there are any exclusions applicable to the transfer. For the reasons set forth below, the transfer did result in a change in ownership because, under the terms of the trust instrument, the trustee holds a sprinkle/spray power so that the trustee may exercise his or her discretion by distributing all of the trust income or principal to one or more unidentified beneficiaries for whom no exclusion is available.

Facts

The relevant facts are that the Trustor created an irrevocable trust ("Trust") on _____ into which he transferred property located in Placer County. The trust instrument recites that the trust is created for the benefit of the Trustor's "descendants." When asked to name whom the descendants were, the Trustor declined. The provision for distribution of the trust income and principal, Article IV, section 1, authorizes the trustee

in the sole discretion of the Trustee, at any time and from time to time, to distribute all or any part of the net income and/or principal of such trust to any one (1) or more of the beneficiaries of such trust in such proportion and amounts as the Trustee shall from time to time determine, in the sole discretion of the Trustee, to be desirable for the best interests of any said beneficiary, or to accumulate all or any part of such net income and the same to the principal of such trust to be held, administered and distributed as a part thereof; provided, however, no distribution shall be made pursuant to the provisions of this Section which would discharge or satisfy a legal obligation of the Grantor.

Law and Analysis

Question 1: Was there a change in ownership when the property was transferred to the trust?

Generally, a transfer of interests in real property to an irrevocable trust results in a change in ownership because it satisfies the elements of section 60 of the Revenue and Taxation Code. In this regard, section 61 provides that "except as otherwise provided in section 62, change in ownership as defined in section 60, includes, but is not limited to: . . . (h) Any interests in real property that vest in persons other than the trustor (or, pursuant to Section 63, his or her spouse) when a revocable trust becomes irrevocable, except as provided in subdivision (d) of Section 62 and in Section 63." Such a transfer or vesting results in a change in ownership as a transfer of the present beneficial interest in the real property interests to the present beneficiary or beneficiaries of the irrevocable trust. This provision reflects the conclusion reached by the Legislature in implementing Proposition 13, as set forth in The Report of the Implementation of Proposition 13, *Property Tax Assessment*, Volume I, October 29, 1979, ("Implementation Report") which makes clear that a transfer of the present beneficial interest from the trustor to the beneficiary occurs when a revocable trust becomes irrevocable as follows:

Under AB 1488, the creation and termination of a trust still generally constitutes a change in ownership; however, the key rests in whether the trust is revocable or irrevocable, and who the beneficiaries are. For example, a change in ownership occurs when a revocable trust becomes irrevocable, unless the trustor or the trustor's spouse remains or becomes the present beneficiary of the trust.

Under the terms of the trust instrument an entire class of beneficiaries, consisting of the Trustor's descendants (both present and future generations), are entitled to *present* distributions of the Trust income based on the sole discretion of the Trustee (Article IV, section 1). As set forth in Property Tax Rule 462.160, subsection (b)(1)(A), there is a change in ownership of trust real property "to the extent that persons other than the trustor-transferor are or become present beneficiaries of the trust unless otherwise excluded from change in ownership." Because the Trustor is not among the beneficiaries of the trust, the exception noted in subsection (b)(1)(A) would not exclude the transfer from a change in ownership.

Question 2: If the transfer results in a change in ownership, are any exclusions applicable to this class of beneficiaries?

For transfers between parents and children and from grandparents to grandchildren, Revenue and Taxation Code section 63.1 generally provides that such transfers of interests in real property are excluded as changes in ownership. Subdivision (c)(9) specifies that "transfer," as used in section 63.1 "includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust."

Pursuant to section 63.1, therefore, if Trustor's son was a named present beneficiary with a specified percentage interest in the trust property, then the portion of the property allocated to Trustor's son would not be subject to change in ownership and reappraisal, provided that the son filed a parent/child claim for exclusion and all other requirements were met. Example 3 following subsection (b)(1)(A) of Rule 462.160 attached, provides an illustration of the application of section 63.1 in this manner.

In this case, the trust instrument does not identify or name the beneficiaries of the trust and refers to them only as the Trustor's descendants. As noted in your fax, the Trustor has declined to state which individuals are intended by the term "descendants." Thus, for purposes of this memo, we are interpreting "descendants" to mean "one who follows in lineage, such as a child or grandchild -- but not a collateral relative."¹ Relying on this definition the descendants could be a child, grandchild, or great-grandchild, etc., or a combination of them all. Consequently, there could be an instance where the Trustor's child ("A") is named as a beneficiary as well as A's child (the Trustor's grandchild). In this instance, although the exclusion pursuant to section 63.1 would apply to the interest transferred to A, the exclusion would not be available to A's child because the exclusion for transfers from a grandparent to a grandchild is applicable only when all parents, as defined by that section, of the grandchild are deceased.

For purposes of making a change in ownership, determination in addition to identifying which persons are "excludable beneficiaries" under an irrevocable trust, it is also necessary to examine the trust instrument to determine whether the trustee has been granted a "sprinkle or spray power." (See attached Cazadd Opinion, 11/5/99.) A "sprinkle or spray power" is a provision which gives the trustee total discretion to distribute trust income or property to a number of potential beneficiaries. Pursuant to Rule 462.160, subsection (b)(1)(A), when a trust contains a sprinkle or spray provision, then unless **all** of the persons included as beneficiaries under that provision qualify for an exclusion from change in ownership 100 percent of the real property interests transferred are subject to change in ownership.

Rule 462.160 (b)(1)(A) provides in relevant part that:

Where a trustee of an irrevocable trust has total discretion ('sprinkle power') to distribute trust *income or property* to a number of potential beneficiaries, the property is subject to change in ownership, because the trustee could potentially distribute it to a non-excludable beneficiary, unless all of the potential beneficiaries have an available exclusion from change in ownership.

Thus, if the trust instrument provides the trustee with discretion to distribute income or principal to beneficiaries who have no available exclusion then a change in ownership of all of the transferred property occurs. Stated differently, any one of the beneficiaries can receive a "present interest" in some, or all of the income in the irrevocable trust, including those for whom no exclusion is available. Therefore, everyone in the group of beneficiaries must have an

¹ (See Black's Law Dict. (7th ed. 1999) p. 455, col. 2.)

Honorable Bruce Dear

July 22, 2002

Page 4

available exclusion. Example 2 following subsection (b)(1)(A) of Rule 462.160 illustrates the foregoing analysis as follows:

H and W transfer real property interests to the HW Revocable Trust. No change in ownership. HW Trust provides that upon the death of the first spouse the assets of the deceased spouse shall be distributed to "A Trust," and the assets of the surviving spouse shall be distributed to "B Trust," of which surviving spouse is the sole present beneficiary. H dies and under the terms of A Trust, W has a "sprinkle" power for the benefit of herself, her two children and her nephew. When H dies, A Trust becomes irrevocable. There is a change in ownership with respect to the interests transferred to the A Trust because the sprinkle power may be exercised so as to omit the spouse and children as present beneficiaries for whom exclusions from change in ownership may apply, and there are no exclusions applicable to the nephew. However, if the sprinkle power could be exercised only for the benefit of W and her children for whom exclusions are available, the interspousal exclusion and the parent/child exclusion would exclude the interests transferred from change in ownership, provided that all qualifying requirements for those exclusions are met.

In the instant case, we interpret Article IV, section 1 granting the trustee sole discretion to make distributions to any member of the class of beneficiaries to constitute a "sprinkle power" within the meaning of the foregoing rule provision. Furthermore, the beneficiaries of the trust may include descendants for whom no exclusions are available, e.g. great grandchildren. Therefore, 100 percent of the property interests transferred are subject to change in ownership and reappraisal, because the trustee could potentially distribute 100 percent of those interests to a beneficiary who is not excludable.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

/s/ Lou Ambrose

Lou Ambrose
Supervising Tax Counsel

LA:tr

prop/prec/trusts/02/05lou

Attachments [Annotation 220.0765, C 11/5/99]

cc: Mr. David Gau, MIC:63
Chief - PPSD, MIC:64
Ms. Jennifer Willis, MIC:70